

GASB STATEMENT 34 IMPLEMENTATION PROCEDURES

Expenses by Function in the Statement of Activities

Procedure

To determine the requirements needed for GASB 34 to present expenses by function in the government-wide statement of activities.

Background

GASB 34, paragraph 41 requires that governments should report all expenses by function in the statement of activities, except those that are special or extraordinary items. The minimum requirement is that all direct expenses should be reported by function. Direct expenses are those that are specifically associated with a service, program, or department, and thus are clearly identified with a particular function. Any expense that is not a direct expense is considered an indirect expense. Some functions may report expenses that are actually indirect expenses of other functions. GASB 34 does not require governments to allocate these indirect expenses to other functions; however, governments may choose to do so. If indirect expenses are allocated, then direct and indirect expenses should be presented in separate columns in order to enhance comparability between those governments that allocate indirect expenses and those that do not. Alternately, if a government charges other functions for centralized expenses that may include an overhead component, it is not required to identify these overhead components and eliminate them. Internal activity will be required to be eliminated in the statement of net assets anyway, but the overhead component will not be required to be identified. Any such overhead components of centralized expenses that are included in direct expenses should be disclosed in the summary of significant accounting policies.

GASB 34 requires that depreciation expense for capital assets that can be identified with a specific function should be included in its direct expenses. For capital assets that are shared by more than one function, the depreciation expense for those capital assets should be shared by those functions based on a pro rata allocation. Depreciation expense for capital assets shared by essentially all functions will be reported in a separate line under governmental activities in the statement of activities, along with the depreciation expense associated with infrastructure. Depreciation expense reporting for the state of Louisiana was discussed in a previous task paper, "Categorizing Capital Assets as Shared Capital Assets or Specific to a Function for Depreciation Expense Reporting Requirements and Options".

Interest expense on general long-term liabilities is generally considered an indirect expense, per GASB 34. This interest expense will be reported in a separate line under governmental activities in the statement of activities. However, any interest expense associated with borrowing that is essential to the creation or continuing existence of a

program should be included with the direct expenses of that program. The indirect interest expense reported as a separate line item should clearly indicate that it does not include any direct interest expense reported in the functions. Any amount excluded from indirect interest expense should be disclosed in the notes or presented on the face of the statement.

Procedure

Governmental Activities

GASB 34 requires that the statement of activities present governmental activities at least at the level of detail required in the governmental fund statement of revenues, expenditures, and changes in fund balances, at a minimum by function. The governmental fund types (general, special revenue, debt service, capital outlay, and the new permanent funds) will all roll up together to be part of the governmental activities portion of the statement of activities. Accordingly, all expenditures reported in the governmental funds will have to be combined and reported by function (as well as be adjusted from modified accrual to full accrual).

- *General Fund* – General fund expenditures are currently broken down into the following functions: General Government; Culture, Recreation, and Tourism; Transportation and Development; Public Safety; Health and Welfare; Corrections; Conservation and Environment; Education; Other; and Intergovernmental. We would use these categories of functions on the statement of activities; therefore, these expenditures would roll up easily into the statement of activities, and nothing different than what we do now would have to be done to report these general fund expenditures as functional expenses under governmental activities.

However, the general fund also reports two categories of debt service under expenditures: principal retirement, and interest and fiscal charges. Principal retirement is reported as an expenditure in the fund statements, but is a reduction in a liability in the statement of net assets and is not reported as an expense in the statement of activities. The interest and fiscal charges will be part of the indirect interest expense in the statement of activities. Added to the interest and fiscal charges will be additional adjustments (such as accrued interest) resulting from converting the fund statements done in modified accrual to the government-wide statement of activities done in full accrual. Additional adjustments could result from internal service fund interest expense allocated to governmental activity in the statement of activities.

- *Special Revenue Funds* – Special revenue fund expenditures are currently broken down into the following functions: Other and Intergovernmental. We would use these categories of functions on the statement of activities; therefore, these expenditures would roll up easily into the statement of activities, and nothing different than what we do now would have to be done to report these special revenue fund expenditures as functional expenses under governmental

activities. Most special revenue funds do not report expenditures, but some funds have expenditures reported as “other” expenditures. The Intergovernmental category of special revenue funds includes special revenue boards and commissions, which report all of their expenditures by object to OSRAP, and OSRAP rolls the total expenditures into the intergovernmental category.

- *Debt Service Funds* – Debt service funds currently report expenditures under the Other expenditure category (Bond Security and Redemption Fund). We would use this category of functions on the statement of activities; therefore, these expenditures would roll up easily into the statement of activities.

Debt service funds also report two categories of debt service under expenditures: principal retirement, and interest and fiscal charges. Principal retirement is reported as an expenditure in the fund statements, but is a reduction in a liability in the statement of net assets and is not reported as an expense in the statement of activities. The interest and fiscal charges will be part of the indirect interest expense in the statement of activities. Added to the interest and fiscal charges will be additional adjustments (such as accrued interest) resulting from converting the fund statements done in modified accrual to the government-wide statement of activities done in full accrual. Additional adjustments could result from internal service fund interest expense allocated to governmental activity in the statement of activities.

- *Capital Projects Funds* - Capital projects funds report capital outlay expenditures. However, these expenditures are actually the result of the purchase or construction of capital assets. Under full accrual in the government-wide statements, the cost of the purchase or construction of capital assets will be allocated over the capital assets' estimated useful lives and reported as depreciation expense in the statement of activities. The difference between the amount reported as capital outlay expenditures in the fund statements and the amount reported as depreciation expense for the year (allocated among functions when required) in the statement of activities will be a reconciling item between the governmental funds' Statement of Revenues, Expenditures, and Changes in Net Assets and the Statement of Activities.
- *Permanent Funds* – A permanent fund is a fund used to report resources that are legally restricted in that only earnings and not principal can be used to support the reporting government's programs (for the benefit of the government or its citizens). Therefore, it is likely that the non-expendable trust funds will be reported as permanent funds under GASB 34. Currently, the non-expendable trust funds report expenditures under the “Other” categorization. We would use this category of functions on the statement of activities; therefore, these expenditures would roll up easily into the statement of activities.

Business-Type Activities

GASB 34 requires that business-type activities should be presented at least by segment in the statement of activities, not by function as is required for governmental activities. A segment is an identifiable activity reported as or within an enterprise fund or an other stand-alone entity for which one or more revenue bonds or other revenue-backed debt instruments are outstanding. A segment has a specific identifiable revenue stream pledged in support of these revenue bonds or other revenue-backed debt, and has related expenses, gains, losses, assets, and liabilities that can be identified. Currently, enterprise funds report expenditures by object; however, they will be reported by segment in the statement of activities, and all expenditures will be added together as one lump sum for expenses for each segment; therefore, expenses for business-type activities do not have to be reported by function.

Discrete Component Units

In a separate issue paper, "Reporting Component Units", we recommended that all discretely reported component units of the state, including colleges and universities, follow the enterprise fund model and report as special-purpose governments engaged only in business-type activities. We chose this model in part because it would require full accrual for the discrete component units' financial statements, which would roll up better into the government-wide statements, also presented at full accrual. For the statement of activities in the CAFR, the discrete component units would be required to prepare a simplified statement of activities. Component unit expenses would be presented as a lump sum figure for each of the major component units, and all other component units would be combined together in one line in the government-wide statement of activities. Accordingly, rolling up the expenses of the discrete component units into the government-wide statement of activities will be easily accomplished, and will not be required to be split by function.

For presentation of the component units in the combining statements in the CAFR, and in their own separately issued financial reports, discrete component units that currently report under the proprietary type are presenting their expenses by object. This would not have to change under GASB 34. GASB 34, paragraph 101 requires only that the presentation of operating and non-operating expenses should be detailed. Implementation Guide Question & Answer No. 211 explains that some governments may use "natural" (or object) classifications, and others, such as a public university, may use functions.

Most of the discrete component units that currently report as governmental types are submitting expenditures to OSRAP by some type of object classification. OSRAP reclassifies these expenditures into a functional categorization for CAFR presentation. These discrete component units will also have to switch from modified accrual to full accrual. We recommend that all discrete component units except colleges and universities continue or begin to submit expenditures by object classification. Also, these entities will be required to switch to expenses at full accrual by object

classification for the Fiscal Year 2002 CAFR for implementation of GASB 34. This would enable one combining Statement of Revenues, Expenses, and Changes in Net Assets for discrete component units other than colleges and universities to be prepared in the CAFR, and would disrupt the least number of entities to switch all to expenses by object.

Colleges and Universities currently report expenditures by function. We recommend that they continue to use functional classifications for expenses under GASB 34, but report depreciation expense as a separate line item. Depreciation expense will have to be separated from other expenses to facilitate preparation of the cash flow statement. We feel that this will require the least amount of changes in the transition to GASB 34 and expedite completion of the college and university statements for inclusion in the CAFR.